IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 636

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

NEW ENGLAND ELECTRIC SYSTEM ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR RESPONDENTS

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*The provisions of Sections 1(b) and (c), 2(a)(29), 8, and 11(b)(1)(A)-(C) of the Public Utility Holding Company Act of 1935 are set forth in Appendix A to this brief.

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STATUTE INVOLVED

The following sections of the Public Utility Holding Company Act of 1935 (the "Act"[1]) are relevant and are set forth in Appendix A to this brief: Sections 1(b) and (c), the statement of purposes and policy of the Act; Sections 2(a)(29)(A) and (B), the applicable definitions of an "integrated public-utility system"; Section 8, the statement of the circumstances under which electric and gas utility companies serving the same territory may be acquired; and Section 11(b)(1)(A)-(C), the statement of the circumstances and conditions under which additional systems may be retained.

[1] 49 Stat. 803-38 (1935), as amended, 15 U.S.C. §79 (1964).

QUESTION PRESENTED FOR REVIEW

The Petitioner's[2] statement of the question presented seems to imply (i) that the meaning given in this case by the Securities and Exchange Commission to the phrase "substantial economies" is long standing and (ii) that the Commission's use of a test based on that meaning has been so extensive and consistent as to entitle it to special consideration by the courts, neither of which is accurate. The Respondents say that the question presented for review is:

> Do the common words "substantial economies" as used in Clause (A) of Section 11(b)(1) of the Act have their normal meaning, that is, economies which in ordinary business judgment would be regarded as important or significant considering the business to which they relate, the meaning which, in connection with Section 2(a)(29)(B) of the Act in this case, the Commission tacitly assumed for them and the Petitioner now urges for them (Br. 25);[3] or for the purposes of Section 11(b)(1)(A) alone are the words to be so construed that economies, however important, are not to be deemed substantial unless their loss would render the additional system incapable of sound and economical operation, a meaning which cannot be found in the words themselves and is not suggested by anything else in the Act?

STATEMENT OF THE CASE

The Petitioner's "Statement" (Br. 3-7) is inaccurate and incomplete in the following material respects:

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[2] In this brief the Securities and Exchange Commission as represented by counsel before this Court and the court below is generally referred to as the "Petitioner"; and otherwise it is referred to as the "Commission".

[3] "Significant savings" is the interpretation suggested by the Petitioner for purposes of Section 2(a)(29) (B) (Br. 25). (In this brief references to the Petitioner's brief on the merits are indicated by "Br."; references to the Petition for a Writ of Certiorari are indicated by "Pet.".)

1. *The Issue Under Section 2(a)(29)(B).* The Petitioner states that after deciding that NEES' electric utility subsidiaries constituted a single integrated system under Section 2(a)(29)(A),

> ". . . the Commission proceeded to hold further hearings, commencing May 18, 1960, on the question whether NEES' gas utility subsidiaries—which both NEES and the Commission's staff agreed to consider as constituting an 'integrated gas utility system' within the meaning of Section 2(a)(29)(B) [citations]—could be retained by NEES as an 'additional integrated public-utility system' under Section 11(b)(1)." Br. 4.

This implies, if it does not actually state, that the status of the NEES gas companies under Section 2(a)(29)(B) was not in issue at the hearings because the question had been settled before or at the beginning of the hearings and that for this reason the Commission did not have to enter any findings or conclusions or statement of reasons on this issue, as required by the Administrative Procedure Act.[4] Thus the Petitioner states:

> "The Commission did not in fact adjudicate the issue whether there were 'substantial economies' as used in Section 2(a)(29)(B) (which defines 'integrated gas system') but merely accepted its staff's concession that NEES's gas companies formed an integrated system as defined in that section, in order to expedite resolution of the critical question under Section 11." Br. 9.

The court below pointed out, however, that the Petitioner, as it recognized in its brief, was committed to the proposition that "fundamentally different meanings" must be given to the test of "substantial economies" under Sections 2(a)(29)(B) and 11(b)(1) (R. 1463).[5] The court

[4] See Section 8(b); 60 Stat. 242 (1946), 5 U.S.C. §1007(b) (1964).

[5] The statement in the Petitioner's brief below was that "NEES had urged this position [that the NEES gas companies constitute a single integrated gas utility system] (R. 23-24, 46-47, 49), the Commission's Division of Corporate Regulation [the staff] agreed (R. 772) and the Commission *so held* (R. 1256)." (Emphasis added.)

stated that "it stands that the Commission feels that saving $329,400 annually by integrating the eight gas companies is effectuating substantial economies under section [2(a)] (29)(B), but that $1,098,600 annually is not substantial economies under Clause (A)." R. 1463 n. 8.[6]

In view of the confusion now created, the following relevant procedural facts should be noted:

(a) Whether the gas utility companies constituted one or more integrated systems under Section 2(a)(29)(B) was one of the principal issues in the case, and was recognized as such at the hearing. This issue was specifically included in the Commission's Order of Notice, which first stated the corresponding issue relating to the electric utility assets in exactly the same terms, and which also specified the issue under Section 11(b)(1) relating to the retention of any additional systems (R. 20; see also R. 40). There was no stipulation or agreement on the Section 2(a)(29)(B) issue, and at no time did either the staff or the Respondents even suggest disposing of it otherwise than through appropriate findings by the Commission in the regular way. The Respondents introduced extensive evidence relating to this issue (see, *e.g.*, Res. Ex. 58A; R. 131, R. Vol. IV; R. 772-73),[7] and at the hearings the staff insisted that determination of the issue under Section 2(a)(29)(B) was a necessary and orderly first step before decision of the issue under Section 11(b)(1) (R. 270-71, 767-68; see also 1263-64 n. 13). In fact, it was not until May, 1961, approximately one year after completion of the Respondents' affirmative case (not at the beginning of the hearings as the Petitioner's brief implies), that the Commission's staff for

[6] In this brief the opinion of the court below is cited by reference to the page numbers of the opinion as reprinted and included in the record for this Court.

[7] "R. Vol." refers to Volume IV, V or VI of the record which are the three volumes of the Ebasco Report. They summarize the severance study made by Ebasco Services, Inc., a firm qualified and experienced as experts in the utilities field. (See R. 1263, 1466, 1469.) The volumes were specified in the Respondents' cross-designation mailed for filing on December 30, 1965.

the first time disclosed its intention at an appropriate time to urge the Commission (R. 772) to make the determination that the NEES gas companies are a single integrated system. In its brief filed with the Commission after the hearings the staff did in fact urge the Commission to make that determination.

(b) The Ebasco Report and related exhibits and testimony which constituted the major portion of the Respondents' evidence showed that if the NEES gas companies were not a single integrated system and had to be operated independently of each other as well as independently of NEES, the annual loss of economies to the gas companies would be $1,495,000 (See Res. Ex. 58A; R. 131, R. Vol. IV; Res. Ex. 59; R. 132, R. 1311). The evidence also showed that if the NEES gas companies were a single integrated system and could be operated together with each other but had to be divested by NEES, the annual loss of economies to the gas companies (as adjusted by the Commission) would be $1,098,600 (R. 1264-65).[8] On the basis that the gas companies were a single integrated system, the Commission refused to consider the larger amount on the ground that it was irrelevant (R. 1263-64 n. 13).

2. *The Commission's Handling of the Evidence.* The "Statement" says, "The Commission found that NEES's

[8] The Ebasco Report showed that the annual loss of economies to the gas companies as a single system would be $1,165,600 (Res. Ex. 91 p. 40; R. 564, R. Vol. VI p. 40). However, NEES also introduced evidence indicating that a change in service company charges authorized by the Commission in December, 1959 would have reduced the loss to the gas companies by $67,000 if it had been in effect in 1958 (R. 364-79), and as noted above the Commission reduced the Ebasco estimate by this amount. Since the evidence otherwise related to 1958 (and to a limited extent 1959), the Commission's adjustment for a change effective beginning in 1960 was retroactive. However, it was minor and in itself might have been correct if the $804,800 annual loss of economies which the evidence showed the electric companies would bear as a result of severance were to be correspondingly increased by $67,000. (See R. 374-75. See also Res. Ex. 58B; R. 131, R. Vol. V; Res. Ex. 60; R. 133, R. 1313). The adjustment also raised the question whether one retroactive adjustment should be made without review and evaluation of other post-1958 developments.

estimate of the loss of economies following from divestiture was exaggerated . . ." (Br. 6). It follows with a lengthy footnote on this point (Br. 6 n. 5).

The "Statement" fails to point out that in its Findings and Opinion the Commission rejected the Ebasco estimate in its entirety for purposes of Section 11, not merely that it considered the evidence exaggerated (R. 1268). It also fails to point out that the Commission's handling and evaluation of the evidence were in issue before the First Circuit, which criticized the Commission's treatment of the evidence in numerous respects, and gave specific and careful instructions as to the correct methods to be followed by the Commission on remand (R. 1466-70).

3. *The Claim that the Test Now Urged is Long Standing.* As to the Commission's holding that $1,098,600 annually was not "substantial economies" for the NEES gas companies the "Statement" says:

> "In so holding, the Commission interpreted the relevant provision [Clause (A)], as it had done in prior divestment cases dating back more than twenty years, to require a showing that each 'additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment of that system' (R. 1262-63). Under this test, the Commission ruled that, on the basis of the record before it, it was unable 'to find that the gas companies could not be soundly and economically operated independently of NEES***' (R. 1279)." Br. 7.

In its Petition for a Writ of Certiorari the Petitioner claimed much more. There it said that its test was the same as "it had applied in every other divestiture case under Section 11(b)(1)" (Pet. 5); that under the test "more than $2,000,000,000 in utility assets have heretofore been divested on orders of the Commission" (Pet. 12); and that decisions of the Commission applying the test stretched uninterrupted through thirteen cited cases back to the first opinion on the question in 1942 (Pet. 12, 26a).

The present "Statement" suggests that the test now urged by the Petitioner is not the same as has been applied in all prior cases. The Respondents concur. The present test has been stated in no more than three of the thirteen cases cited in the Petition, involving less than 7½% of the total assets stated in the Petition to have been divested in relevant cases. In none of them does it appear to have been dispositive of the issue. (See pp. 45-48 and Appendix B to this brief.)

4. *Participation of the Massachusetts Department of Public Utilities.* The "Statement" contains no reference to the fact that the Massachusetts Department of Public Utilities (the "DPU"), which has jurisdiction over and regulates both gas and electric companies in Massachusetts, including all of the NEES gas companies, intervened as a party in the proceedings before the Commission and strongly opposed divestment of the gas companies. The Chairman of the DPU testified at length to the effect that in Massachusetts joint ownership or operation of gas and electric utilities is in no way contrary to public policy, that each case depends on its own circumstances, that 16 of 26 gas companies in Massachusetts are either combination gas and electric companies or under common control with electric companies, and that in the case of the NEES System there had been no suppression of one business in favor of the other. To the contrary, the DPU's experience with the System indicated that the gas and electric businesses had each been "aggressively developed and efficiently operated", as evidenced by the favorable rate of growth of each. The Chairman pointed out that in Massachusetts gas companies are in an "economic squeeze" because the cost of gas piped from the southwest is relatively high, and gas and fuel oil (oil being shipped by water is relatively cheap) compete intensely for home heating, the principal market for gas. The view of the DPU was that divestment would be adverse to the interests of the residents of Massa-

chusetts, and might necessitate increased gas rates; that it would not achieve any benefits but would result in the impairment of service and the loss of substantial economies; and that the loss would fall ultimately on the consumers (R. 41-42, 581-82, 587-94).

SUMMARY OF ARGUMENT

The Holding Company Act is a business regulatory statute written in simple and unambiguous language. It contains a clear and specific statement of its objectives and policy, and of the procedure for implementing them. It can be and should be applied without distortion of its provisions.

The specific issue in this case is the meaning of the phrase "substantial economies" as used in Section 11(b)(1)(A), which states one of the conditions for common control of more than one integrated public-utility system. The same phrase appears in a similar context in Section 2(a)(29)(B), as a requirement in the definition of an "integrated public-utility system" consisting of one or more gas companies.

In the proceedings before the Commission, the test of "substantial economies" in both Sections had to be applied to the eight NEES gas companies — under Section 2(a)(29)(B) in determining whether they could be held together with each other in a single integrated system, and under Section 11(b)(1)(A) in determining whether they could be held together with the NEES electric companies in a single holding company system. There was no question that all other requirements were met.

The evidence showed that operation of these gas companies together with each other resulted in economies of $329,400 a year, and that operation of them together with the electric companies resulted in economies of $1,098,600 a year. On this record, the Commission "conceded" that the eight gas companies constitute a single integrated

public-utility system, thereby recognizing and in effect holding that for them economies of $329,400 are "substantial" under Section 2(a)(29)(B). It then held that economies for the same companies of $1,098,600 are not "substantial" under Section 11(b)(1)(A). (See R. 1256, 1269).

In conceding the issue under Section 2(a)(29)(B) instead of entering the appropriate findings and conclusion, which would have directed its attention to the crucial inconsistency of its position, the Commission ignored the requirements of the Administrative Procedure Act and its own Order of Notice, reversed its well established practice, and acted inconsistently with its action on other parallel issues in the same case, all without explanation. Successive explanations have since been offered, but each of them involves further inconsistencies and other difficulties. This aspect of the case alone warrants remand to the Commission for further appropriate proceedings.

The Commission's treatment of the issue under Section 11(b)(1) is correspondingly defective. In its Findings and Opinion it stated so many standards under Clause (A) that the court below had difficulty in determining the actual basis of the decision. It concluded that the Commission had construed the phrase "substantial economies" to mean economies whose loss "would render impossible 'economical or efficient operation.'" R. 1458. The Petitioner now substitutes "sound and economical operation", although its brief states that in all prior cases the Commission has construed the phrase to mean economies the loss of which would "cause a serious impairment of that [the additional] system" (Br. 7), a materially different test.

The test of incapability of sound and economical operation represents a radical departure from the normal meaning of the phrase "substantial economies". It requires a different line of inquiry — an examination of the operational capability of the system after separation rather than

a comparison of operations before and after separation. It is a substitution of a different test which the Commission thinks is a better test but which cannot be found in the language of the Act.

The Petitioner's interpretation of the Act is evidently based on a preconceived assumption that the Act reflects an overriding federal policy against retention of more than one integrated public-utility system, and particularly against combination of gas and electric operations. It assumes this policy to be so strong as to require whatever distortion of specific provisions of the Act may be necessary to give it maximum effect. Thus a special meaning for the phrase "substantial economies" in Clause (A) of Section 11(b)(1) should be used, the Petitioner in effect argues, since otherwise that Section specifically permits combinations contrary to the assumed policy. Yet the same phrase in Section 2(a)(29)(B) can be given its normal meaning because "an entirely different policy" applies (Br. 25). The Respondents submit that the two Sections implement the same federal policy, which is carefully stated in Section 1 and is not the policy now urged by the Petitioner.

The Petitioner's argument is in striking contrast to the Commission's statement in its Findings and Opinion below (R. 1277) that it does not take the view that the Act expresses a federal policy against combined gas and electric operations as such; and it ignores strong evidence in the Act and its legislative history indicating that Congress intended to leave this question to the individual states, and limit its own concern to preventing the use of holding companies to circumvent state law and policy.

The legislative history, even as summarized by the Petitioner, is not helpful to its position. Congress not only refused to adopt the original bills embodying the harsh policy now favored by the Petitioner, but it took the precaution to forestall the Commission's achieving the same

result in administrative practice, as it is now attempting to do, by providing in Section 11(b)(1) that the Commission *shall* permit retention of additional systems if specific conditions are met.

The Petitioner's chief reliance is on a single remark of Senator Wheeler. The remark, however, was made after the Act was passed, by an opponent of the compromise embodied in it. Under these circumstances, as the court below suggested, the Senator's statement is entitled to little if any weight.

So far as the Act itself is concerned, the Petitioner cites two phrases taken out of context and completely misconstrues them (Br. 17, 20). If the entire subsections from which they were taken are examined, it is clear that the phrases do not relate to the question presented in this case.

The Petitioner's novel suggestion that its test should be favored because it permits giving effect to certain assumed competitive advantages is troublesome in several ways. The ability to take into account particular factors should have no bearing on the determination of what the test is. The test should first be determined from the Act itself, and that in turn determines what factors are relevant. Furthermore, no explanation is given as to how or why the competitive advantages or disadvantages of independence, can be given more meaningful consideration under the Commission's test than under the court's test. Just the reverse would appear to be true.

Finally, the Petitioner claims that the "Commission's longstanding interpretation is entitled to great deference." Br. 26. A crucial difficulty with this argument is that the various tests used by the Commission have been so loosely and inconsistently stated that it is difficult to interpret and evaluate the decisions of the Commission, or even of the reviewing courts. Any semblance of uniformity depends on treating as synonymous a variety of words and phrases

having a wide range of meanings, and it completely disappears when exact meanings are brought into focus.

Over the years and even in this case, the Commission has announced so many tests that it cannot be said that there is a specific Commission interpretation, long standing or otherwise. In only a small percentage of the Commission's decisions cited in its Petition for Certiorari has the Commission even stated the test now urged, and in none of them does it appear that this test was determinative of the issue.

In the courts, in earlier cases, the Second Circuit approved a test based on the importance of the economies, and the Court of Appeals for the District of Columbia in two subsequent cases appears to have followed this test or developed an intermediate test, but in neither was it determinative of the issue. The Fifth Circuit and (in the decision under review) the First Circuit have been the latest to consider the meaning of "substantial economies". Both have unanimously rejected the Commission's present test.

ARGUMENT

I. The Holding Company Act Sets Forth in Clear and Unambiguous Language a Comprehensive, Rational and Self-Consistent Plan of Regulation which should be Administered according to its Own Terms.

The Act was designed to combat certain evils which had come about in connection with the abnormal and unregulated growth of holding companies in the public utility industry. Section 1 itemizes these evils and declares it to be the policy of the Act, "in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section . . . ."

The subsequent sections provide the machinery for implementing the policy declared in Section 1 by bringing

each holding company system into conformity with specified standards and then regulating subsequent acquisitions and other activities in the manner and to the extent specifically provided.

1. The Act is a Business Regulatory Statute Using Well Understood Business Terms and its Meaning is Clear.

The Act was intended to effect extensive reorganization and continuing regulation of one of the major industries of the United States — "the rationalization of an industry", to use former Commission Chairman Cary's description.[9] It directly affected business, and was written in simple everyday English words having well understood meanings in the business world. Where technical or special terms were required they were clearly defined. Legislative history makes it clear that the Act was intended to accomplish its purpose "without undue dislocation of investment or the loss of operating economies which flow from economically and geographically integrated public-utility systems." (See pp. 25-26 below.)

The specific issue in this case is the meaning of the phrase "substantial economies," as used in Section 11(b)(1)(A) of the Act. The Respondents say it means economies or savings which are important or significant in relation to the business involved, the connotation it would unquestionably have in ordinary business parlance. The Petitioner says it means the difference, however large or significant the amount may be, between capability and incapability of sound and economical independent operation, and it rephrases the test accordingly.

The Respondents contend that under established principles of statutory construction, the words of the Act are

[9] Cary, *Administrative Agencies and the Securities and Exchange Commission*, 29 Law & Contemp. Prob. 653, 655 (1964).

presumed to have their normal and usual meanings, and specifically that identical words and phrases in closely related sections have the same meanings. Any departure from this principle would require compelling reasons, which as shown below (pp. 22-51), are not here present.

2. The Petitioner's Test under Section 11(b)(1)(A) is Outside Any Normal Meaning of the Language of the Statute and Involves Fatal Inconsistencies.

The Petitioner's test is not properly described as an interpretation or construction of the phrase "substantial economies". It is a substitute — a new standard which is materially different from the one adopted by Congress. The difference is not one of degree or strictness. It is a difference of kind.

The Petitioner's test requires an examination of the pro forma operation of the additional system as an independent system, and nothing more. If it cannot be proved by "clear and convincing evidence" (to use the Commission's phrase (R. 1262)) that the additional system is incapable of operating soundly and economically as an independent system, the Commission requires divestiture. Specifically what is meant by operating "soundly and economically" is not explained.[10] But whatever the meaning, under the Petitioner's test the size and the importance of economies produced by existing combined operation, and the impact of the loss of those economies on consumers and investors, are irrelevant.

This result is contrary to the ordinary meaning and plain intent of the words "substantial economies". The word "economies" connotes savings, and there are no

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[10] The court below considered it a serious problem, which, however, it did not have to reach, that the Commission had failed to explain the standard "by which uneconomical operation is determined." R. 1458 n.5, R. 1461 n.7.

savings and hence no economies unless one situation, when compared with another, represents an improvement. "Substantial" is a relative term and in a legal context it means important or significant. Together the words convey a clear intent to require an evaluation of the importance or significance of the savings, the difference between the two situations, in light of all the circumstances.

The Petitioner's test is markedly inconsistent with the method of decision which the Commission has regularly used in other cases and apparently actually used in this case. (See R. 1282, Br. 34.) Here the Commission first measured the projected annual loss of economies in percentages of the NEES gas system's annual operating revenues, operating revenue deductions (excluding federal income taxes), gross income and net income before federal income taxes. It then compared these ratios in detail with similar ratios which it had used to test the substantiality of economies in certain earlier cases (R. 1269-70, 1282). Thus, it has appeared that the dollar size and related percentages of the losses went to the heart of the Findings and Opinion in this case as well as prior cases. The Petitioner's present position must mean that the ratio tests the Commission said it was using were not the real basis for its decision either in this case or the cited prior cases, and that the Commission was performing an essentially meaningless task.[11]

If Congress had intended the result which the Petitioner now urges, it cannot be doubted that the expert draftsmen of the Act would have stated that intention clearly and

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[11] In particular it should be noted that when it reviewed the evidence relating to NEES's estimate that rate increases of about $1,500,000 would be necessary to avoid reduction in the earnings of the gas companies after severance, the Commission stated that the test of Section 11(b)(1) "is not based on reduction in earnings upon severance but solely upon whether the increased operating costs occasioned by severance are 'substantial'." R. 1273.

simply and indeed in fewer words. Clause (A) would have read:

> *"(A) Each of such additional systems cannot be soundly and economically operated as an independent system."*[12]

The requirements of Clauses (A), (B) and (C) of the *proviso* were not a mere legislative afterthought. As explained below in detail (see pp. 26-30), insertion of the *proviso* containing them was the key step in the passage of the Act. The three elements of the *proviso* — the limitation of operations to a single geographic area, the limitation on size and the test of economic justification — closely parallel, in both substance and form, the corresponding elements in the definitions of an integrated public-utility system set forth in Section 2(a)(29):

(i) *The geographic limitation:* The definitions in Section 2(a)(29) require that the operations of an integrated system be confined to a single area or region; Clause (B) of the *proviso* in Section 11(b)(1) requires that all of the additional systems be located "in one State [in which the principal system also operates[13]], or in adjoining States, or in a contiguous foreign country. . . ."

(ii) *The size limitation:* Both the definitions and Clause (C) of the *proviso* require in virtually identical terms that operations be "not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation".

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[12] This restatement of Clause (A) merely inserts the Petitioner's phrase "soundly and economically" and deletes the phrase actually used: "without the loss of substantial economies which can be secured by the retention of control by such holding company of such system".

[13] See Engineers Pub. Serv. Co. v. SEC, 138 F.2d 936, 941-43 (D.C. Cir. 1943), *cert. granted*, 322 U.S. 723 (1944), *dismissed as moot*, 332 U.S. 788 (1947).

(iii) *The economic justification:* Both the definitions and Clause (A) of the *proviso* require economic justification for continued combination. The definition of an integrated gas utility system in Section 2(a)(29)(B) does not require that the gas companies be physically interconnected or capable of physical interconnection, as such interconnection is not ordinarily beneficial, but it requires that "substantial economies" be effectuated by the gas companies being operated as a single coordinated system. Clause (A) of the *proviso* does not require physical interconnection or capability of physical interconnection as ordinarily such interconnection would not be feasible or beneficial, but it has the same requirement of "substantial economies". The definition of an integrated electric system in Section 2(a)(29)(A) is different and reflects technical advantages of interconnection available in electric operations: it requires physical interconnection (or capability of physical interconnection), and if that advantage is present, it requires only that the electric facilities normally may be economically operated as a single interconnected and coordinated system (not necessarily effect substantial economies).[14]

If, as the Petitioner now argues, capability of sound and economical operation is the test under Clause (A), an integrated gas utility system can never be retained as an additional system, whether the principal system is gas or electric. By definition the additional gas system must

[14] The different standard for electric systems reflects the fact that by interconnection an electric system realizes economies and other benefits from joint use of generation facilities, power interchange, common dispatching and the like. With these technological advantages present, other economies, such as those resulting from common management and operation of non-interconnected properties, need not be "substantial" under the Act in order to justify the properties being allowed within one system. Thus despite the Petitioner's assertion to the contrary (Br. 26 n. 19), Congress did have a valid reason for imposing somewhat different standards for integration of an electric system as compared to a gas system.

consist of one or more gas companies so located and related that substantial economies may be effectuated by their being operated as a single system. To achieve those economies, the gas companies have to be *capable* of operating together economically. But if they are capable of operating together economically and so are an integrated system, they must in all cases be separated from the principal system because under the Petitioner's test the only additional system which may be retained is one which is *incapable* of sound and economical operation.

The geographic, size and economic tests of Sections 2(a)(29) and 11(b)(1) of the Act clearly should be construed consistently, as should in particular the phrase "substantial economies", which appears in both Sections. To do so is not only logical; it gives effect to the recognized rule of statutory construction that the same word or phrase appearing in different parts of a single statute is presumed to have the same meaning. *United States* v. *Cooper Corp.*, 312 U.S. 600, 607 (1941). This presumption should be particularly strong where, as here, the identical phrase ("substantial economies") not only appears in the two Sections but is incorporated by reference into Section 11(b)(1) through that Section's use of the defined term "integrated public-utility system". The draftsmen of the *proviso* in Section 11(b)(1) must have intended the words they used to have the same meaning there as in the definitions in Section 2(a)(29), as the most important use of the defined term "integrated public-utility system" in the Act unquestionably is in the application of Section 11(b)(1).

The Commission has recognized the rule of statutory construction stated in *Cooper*, and until this case has followed the rule when it compared corresponding provisions of the two Sections.[15] It stated to this Court in its reply brief defending its interpretation of Clause (A) in *Engineers:*

[15] See North American Co., 11 S.E.C. 194, 214 (1942), Cities Serv. Power & Light Co., 14 S.E.C. 28, 59 (1943), and Commonwealth & Southern Corp., 26 S.E.C. 464, 488-89 (1947) (involving

"Indeed the relationship of dependence required for retention is particularly clear in the case of gas properties because the definition of a single integrated system in Section 2(a)(29)(B) applicable to gas properties substantially overlaps the standards of the (A) and (C) clauses of Section 11(b)(1), as they apply to additional systems. Thus it is clear that Congress intended the relationship between a single system and an additional system should be comparable to that between parts of the same system . . . ."[16]

In an attempt to avoid the obvious inconsistencies, the Petitioner has first suggested that there was an agreement or stipulation on this issue (there was none), and alternatively suggests that the "Commission did not in fact adjudicate the issue" under Section 2(a)(29)(B), "but merely accepted its staff's concession" (Br. 4, 9). For this reason, the Petitioner argues, it is unfair to "tax the Commission with inconsistency" (Br. 23).

The established practice of the Commission under the Act, however, has not been to accept without question and

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Section 2(a)(29)(A) and clause (C) of Section 11(b)(1)). See also Lone Star Gas Corp., 12 S.E.C. 286, 295 (1942), and United Gas Improvement Co., 9 S.E.C. 52, 72 (1941). The Petitioner now takes a contrary view (Br. 23-24), and suggests that Atlantic Cleaners & Dyers, Inc. v. United States, 286 U.S. 427 (1932), supports its view. That case, however, stands for the proposition that while there is a natural presumption that identical words appearing in the same statute are intended to have the same meaning, this presumption can be overcome when the words appear in two separate sections of a single statute in which Congress intended to exercise to the fullest extent two different constitutional powers, one of which is significantly more extensive than the other. In that situation, the Court stated that it would construe the two sections as if they were in different statutes and interpreted each section so as to give each maximum effect within the applicable constitutional provision despite the fact that to do so resulted in similar words in the two sections being dissimilarly construed. See 286 U.S. at 433-35.

[16] Reply Brief for Commission pp. 19-20, Engineers Pub. Serv. Co. v. SEC, *cert. granted,* 322 U.S. 723 (1944), *dismissed as moot,* 332 U.S. 788 (1947).

take no responsibility for a staff concession. In prior cases, the Commission has considered that its statutory duties could not be properly carried out in this way. In appropriate cases the Commission has rejected the concurrence of its staff and the respondent involved and has reached a contrary conclusion. For example, in *Cities Service,* counsel for the Commission's staff and for Cities Service concurred in recommending that the Commission find certain non-utility businesses retainable under the standards of Section 11(b)(1). But the Commission reached a different result and stated, quite rightly, that:

> "The concurrence of counsel, however, does not change our statutory duties. We may make the affirmative findings necessary to permit retention of a nonutility business only if the record shows that such retention satisfies the criteria of Section 11(b)(1)." *Cities Serv. Power & Light Co.,* 14 S.E.C. 28, 38 (1943).[17]

In other words, the Commission in its actual practice has recognized that, as noted by the court below, it "could not, either in good conscience or in law, accept as a concession a matter [that is, the gas companies' status under Section 2(a)(29)(B)] so fundamental, not only to the present proceedings, but for the future, if it were contrary to the fact" (R. 1463 n. 8). For that reason, even when the Commission has chosen to follow the recommendations of its staff on material issues under the Act, it has been careful to state its reasons and the necessary subsidiary findings. The Commission did just that both in its Findings and Opinion with respect to the electric phase of this case (where the staff did not oppose the Respondents' position), and in its Findings and Opinion with respect to the issues under Clauses (B) and (C) of Section 11(b)(1) in the gas phase of this case, where the staff also did not oppose the Respondents' position.[18]

[17] See also Middle West Corp., 15 S.E.C. 309, 329, 334 (1944); Northern States Power Co., 36 S.E.C. 1, 5, 8-10 (1954).

[18] See R. 27-38; New England Elec. Sys., 38 S.E.C. 193 (1958); R. 769, 1260-61; see also General Pub. Util. Corp., 32 S.E.C. 807, 814-15 (1951).

The Respondents do not disagree with the Petitioner's suggestion that it is desirable to narrow the issues and limit the evidence in administrative hearings through such procedures as responsive pleadings and pre-hearing conferences which could lead to appropriate stipulations. (See Br. 9, 2-23.) The problem is that here there was no stipulation, nor was the issue eliminated by the pleadings or by any pre-hearing conference. The Respondents had the burden of proof and introduced their evidence. The Commission had the duty to adjudicate, and under the Administrative Procedure Act to state the necessary findings and its reasons.[19] Had the Commission met that duty, it would presumptively have recognized the inherent inconsistencies in its Findings and Opinion.[20]

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[19] "All decisions (including initial, recommended, or tentative decisions) shall become part of the record and include a statement of (1) findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record; and (2) the appropriate rule, order, sanction, relief, or denial thereof." Section 8(b); 60 Stat. 242 (1946), 5 U.S.C. § 1007(b) (1964). The Petitioner cites a proposed amendment of the Administrative Procedure Act as being consistent with its claim of no adjudicatory responsibility (Br. 23 n.18), but even if that amendment were in effect, it would not help the Petitioner's case. Agreements or admissions still would be required to narrow the issues, and findings and conclusions and reasons would still be required in decisions. See Sections 2(d), 5 and 8(b) of S. 1336, 89th Cong., 1st Sess. (1965). The proposed legislation contemplates, with certain safeguards, agency delegation of adjudicatory functions (Section 8). Of course, that procedure was not available here. However, in 1962 special legislation was passed which authorized the Commission to delegate various duties but in this case the Commission in no way followed the prescribed procedure for delegation of its adjudicatory duties. See 76 Stat. 394 (1962), 15 U.S.C. § 78d-1 (1964); see also Rule 8(a) of the Commission's Rules of Practice. 17 C.F.R. § 201.8(a) (1964).

[20] Assuring careful and reasoned administrative consideration is one of the several well recognized "powerful" and "practical reasons" for the requirement of administrative findings. 2 Davis, *Administrative Law* §16.05 (1958). As this Court has noted,

II. None of the Reasons Advanced by the Petitioner Warrants Distorting the Normal Meaning of the Act and Substituting a Different Standard for that Prescribed in Clause (A).

There is a natural presumption that the phrase "substantial economies" as used in the Act is intended to convey the normal and generally understood meaning of the words. In particular cases there may be need for interpretation as to the degree of substantiality intended and for this purpose resort to legislative history or other aids to interpretation may be appropriate. Under no circumstances, however, can this impose on language a meaning which is opposed to, or outside the widest scope of, its normal meaning. See *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 616-618 (1944). The Respondents contend that this is exactly what the Petitioner is attempting to do in this case. For that purpose the Petitioner offers several reasons, not one of which has any validity.

1. Neither the Act Itself nor its Legislative History Supports the Petitioner's Test under Clause (A).

The Petitioner's case proceeds on the premise that under the Act, and Section 11(b)(1) in particular, the "primary aim" and "basic congressional purpose" are to "restrict a holding company's control over operating utility companies to one integrated public utility system," (Br. 8, 9), or to "limit holding companies to a single integrated sys-

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"Expert discretion is the lifeblood of the administrative process, but 'unless we make the requirements for administrative action strict and demanding, *expertise*, the strength of modern government, can become a monster which rules with no practical limits on its discretion.' *New York* v. *United States*, 342 U.S. 882, 884 (dissenting opinion)." Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 167 (1962).

tem" (Br. 25). This idea is basic to the Petitioner's argument. Repeatedly the point is made: a requirement for one integrated system is said to be the "theme" of the Act (Br. 8); its "basic provision" (Br. 12); the "cardinal principle" (Br. 17); and the "basic congressional plan" (Br. 25).

This bold assumption colors the Petitioner's entire interpretation of the Act and is cited as justification for giving identical words radically different meanings in two closely related sections (Br. 9, 24) and for otherwise distorting the normal meaning. No valid support for it is offered by the Petitioner or is to be found either in the Act or in its legislative history. Yet the Court is asked to make the same assumption.

(a) *The Act.* Obviously the first and most important place to look for the policy and purposes of legislation is in the legislation itself. If the language is clear and unambiguous, there is normally no need to look further.

In the instant case the Act is unusually clear and specific in declaring its policy and specifying its purposes. They relate solely to the elimination of specific enumerated evils. Restrictions on holding companies are means to an end and not an end in themselves. The conditions and limitations under which they are to be applied are clearly stated in the Act and should be fairly and impartially construed. Section 11(b)(1) is not a statement of policy. It is one of several mechanical or operative provisions designed to implement and carry out the policy and purposes of the Act as detailed in Section 1.

The Petitioner contends that the use of the *proviso* in Section 11(b)(1) should be interpreted as indicating an intention to make a "narrow" exception (Br. 8, 12, 15, 17) which is to be strictly construed (Br. 13). This would be questionable under any circumstances and is wholly invalid

in the present context. The particular form of this section was dictated by its legislative history. The original bills in both branches provided for the complete elimination or severe limitation of all holding companies. After careful consideration and extensive public hearings and debate, a material modification took place. The *proviso* was used as an obvious and convenient mechanical method of carving out of the general limitation those situations in which additional systems could be retained consistently with the basic purposes of the Act. Without this modification the legislation would have failed of enactment. Those who voted for it had a right to assume that the language would be fairly interpreted and that the compromise would not be scuttled by distortion of that language.

The Petitioner criticizes the decision of the court below as overemphasizing the business or economic factor in its interpretation of this part of the Act. Actually this is the one factor to which Clause (A) relates. The major considerations of size and geographic distribution are covered by Clauses (B) and (C). A careful reading of the Act as a whole, and particularly of Section 1, can leave no doubt that economy in management and operation was of vital concern, meaning by this, net economy after giving effect to all plus and minus items.

(b) *Legislative History.* The enumeration of evils in Section 1(b) is based on the facts disclosed by various detailed reports, including particularly the reports of the Federal Trade Commission after what has been described as "the most thorough-going investigation of an American industry that has ever appeared",[21] and, in addition, the so-called Splawn Report issued in 1934 and 1935 by the

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[21] Barnes, *The Economics of Public Utility Regulation* 71 n.8 (1942).

House Committee on Interstate and Foreign Commerce.[22] After these reports, in March, 1935, President Roosevelt requested remedial legislation with respect to public-utility holding companies, and transmitted to Congress a report of the National Power Policy Committee. This report summarized the problem as follows:

> "The growth of the holding-company systems has frequently been primarily dictated by promoters' dreams of far-flung power and bankers' schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. Because this growth[23] has been actuated primarily by a desire for size and the power inherent in size, the controlling groups have in many instances done no more than pay lip service to the principle of building up a system as an integrated and economic whole, which might bring actual benefits to its component parts from related operations and unified management. Instead, they have too frequently given us massive, overcapitalized organizations of ever increasing complexity and steadily diminishing coordination and efficiency."[24]

The National Power Policy Committee recommended:

> ". . . Federal legislation regarding public-utility holding companies. Such legislation should eradicate disclosed abuses, prevent the use of the holding company and affiliated interests to obstruct State regulation of operating companies, and make possible the elimination of the

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[22] H.R. Rep. No. 827, 73d Cong., 2d Sess., Parts 1-6 (1933-35). See Commissioner Splawn's summary appearing in Hearings before the House Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. 55-56 (1935).

[23] Not all growth of holding companies, as suggested by the Petitioner's partial quotation in its brief (Br. 13).

[24] H.R. Doc. No. 137, 74th Cong., 1st Sess. 5 (1935).

holding company where it serves no demonstrably useful and necessary purpose, without undue dislocation of investment or the loss of operating economies which flow from economically and geographically integrated public-utility systems.''[25]

Neither the President nor the National Power Policy Committee condemned holding companies as such, nor did they seek legislation which would eliminate the advantages of geographically and economically integrated systems. The President did vigorously condemn large and sprawling utility holding companies which performed no demonstrably useful or necessary function but rather existed simply as a means of achieving and maintaining financial control over operating public utilities.[26]

Senate hearings followed and then in May, 1935, Senator Wheeler introduced the Senate version (S. 2796) of the bill and filed with it the report of the Senate Committee on Interstate Commerce, of which he was Chairman.[27] As had the earlier reports, the report of this committee made it clear that the principal purpose of the legislation was to restore regional integration, local management and effective local regulation. Under the Senate version as introduced by Senator Wheeler a regionally integrated public-utility system was exempt from the elimination provisions of Section 11. A regionally integrated combined gas and electric system, such as NEES, was entirely consistent with

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[25] *Id.* at 8. It was recognized at the subsequent Senate hearings that in New England a holding company serves a particularly useful purpose because the states are small and the holding company is ''necessary to hold together the desirable regional operating units''. See the testimony of Thomas G. Corcoran, Hearings Before the Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. 165, 203-04 (1935).

[26] H.R. Doc. No. 137, 74th Cong., 1st Sess. (1935).

[27] S. 2796; S. Rep. No. 621, 74th Cong., 1st Sess. (1935). S. 2796 extensively revised the form but preserved the substance of S. 1725 and H.R. 5423, the original bills, which had been filed with the Senate and House in February, 1935.

the purposes of the legislation, not an evil condemned by it:[28]

> "An operating system whose management is confined in its interest, its energies, and its profits to the needs, the problems, and the service of one regional community is likely to serve that community better, to confine itself to the operating business, to be amenable to local regulation, to be attuned and responsible to the fair demands of the public, and more often to get along with the public to mutual advantage. A regional system, with each company confined to consolidation of its own territory, will offer no chance for the territorial raids at fantastic prices with which for 15 years competing holding company systems disturbed the operating business. Essentially local systems will tend to operate utilities rather than to play with high finance; and essentially local enterprise is far less likely to accumulate a disproportionate amount of political and economic power." S. Rep. No. 621, 74th Cong., 1st Sess. 12 (1935).

The Senate version of Section 11(b)(1) (S. 2796) was the strict version. It would have limited all registered holding companies to a single "geographically and economically integrated public-utility system". Such a single system, however, could have included both electric and gas properties.[29]

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[28] See Representative Eicher's comment that, ". . . essentially intrastate holding companies, like Niagara-Hudson and Pacific Gas & Electric, and holding companies necessary for the operations of an interstate but regionally integrated public-utility system, like New England Power Association [the former name of NEES], are exempted from the elimination provisions of section 11 of the Senate bill . . . ." H.R. Rep. No. 1318, 74th Cong., 1st Sess. 49 (1935).

[29] S. 2796 § 11(b)(1)-(3), as passed by Senate and sent to House June 13, 1935. See United Gas Improvement Co., 9 S.E.C. 52, 82-83 (1941); Hearings before the Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. 494-500, 515, 626-30 (1935). This was also true under the bill as initially introduced in both the Senate and the House. See S. 1725 § 11(b)(2) and (4)(1935) and H.R. 5423 § 10(b)(2) and (4)(1935).

The House opposed the Senate's strict version of Section 11(b)(1). It therefore amended S. 2796 to permit a holding company to control any number of integrated public-utility systems which the Commission might find could be included in such holding company system "consistently with the public interest."[30]

The House version of S. 2796 contained, for the first time, a definition of an integrated public-utility system which, as ultimately interpreted,[31] limited such a system to either electric or gas business. However, under the House version, the Commission would have been required to permit a holding company to control as many integrated gas and electric systems as the Commission might find could be retained "consistently with the public interest."[32]

As neither the House nor the Senate would accept the other's version of S. 2796, a joint conference committee was appointed and in due course a compromise was reached. In the compromise the Senate withdrew its objection to the House version of S. 2796 subject to inclusion of an amendment deleting the general test of public interest for the retention of more than one system and substituting the more specific geographic, size and economic standards set forth in the ABC tests of Section 11(b)(1). As so amended, Section 11(b)(1) would require the Commission to permit a registered holding company to retain one or more additional systems together with the principal system if these standards were met. The Section made no distinction between gas and electric properties.[33]

[30] S. 2796 § 11(b), as passed by the House of Representatives and sent to the Senate July 9, 1935.

[31] See American Water Works & Elec. Co., 2 S.E.C. 972, 983 (1937) (single system can include both gas and electric properties); Columbia Gas & Elec. Corp., 8 S.E.C. 443, 462-63 (1941), and United Gas Improvement Co., 9 S.E.C. 52, 77-83 (1941) (single system cannot include both gas and electric properties).

[32] S. 2796 §§ 2(a)(27), 11(b), as passed by House and sent to Senate July 9, 1935. See United Gas Improvement Co., *supra* at 80-81 (1941).

[33] See United Gas Improvement Co., *supra*.

The ABC tests were introduced in light of the concern expressed by Senator Wheeler and others over what was considered to be an overly broad delegation of congressional power in the House version.[34] The Managers on the part of the House reported:

"It may be observed that section 11(b) in both the Senate bill and the House amendment contemplates the reestablishment of the advantages of localized management in the operating utility industry and the consequently necessary breakdown of the control of large holding companies over geographically scattered operating utility companies. Section 11 of both bills, therefore, authorizes the Securities and Exchange Commission to require a holding company to limit its control over operating utility companies to one integrated public-utility system.

"To this limitation the Senate bill, like the House bill, allows in section 3 exceptions in the case of a holding company whose interests are essentially intrastate and in the case of a holding company whose interests are essentially foreign. The House amendment grants what amounts to a further exception when the Commission finds that more than one integrated system may be included in a holding-company system 'consistently with the public interest'.

"The conference substitute meets the House desire to provide for further flexibility by the statement of additional definite and concrete circumstances under which exception should be made to the form of one integrated system. Definite exceptions not only provide a satisfactory constitutional standard but also an effective standard for the guidance of both the Securities and Exchange Commission and those holding companies which wish voluntarily to comply with Congressional policy.

"The substitute, therefore, makes provision to meet the situation where a holding company can show a

[34] See 79 Cong. Rec. 10842 (1935) (remarks of Senator Wheeler); H.R. Rep. No. 1318, 74th Cong., 1st Sess. 45 (1935) (additional views of Representative Eicher); 79 Cong. Rec. 10838 (1935), (letter of Joseph P. Kennedy, then Chairman of the Commission).

real economic need on the part of additional integrated systems for permitting the holding company to keep these additional systems under localized management with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located in the same State or States, or in adjoining States or a contiguous foreign country."[35]

The Petitioner argues in effect that the Managers' reference to a "real economic need" means a need so overwhelming that without the economies of combination the additional system would be incapable of economic operation. This, of course, stretches the Managers' actual words (and the words of the Act to which they were referring) far beyond their normal meaning. It wholly disregards the context in which the Managers spoke, that is, the stated objectives of the Act and the broad economic reform which the President and the Congress contemplated. Given that context, it is inconceivable that the Managers could have meant to imply what the Petitioner now urges. The Managers were clearly persuaded that the desire of the House for flexibility was met and that a meaningful standard satisfactory to the Senate and the House had been included. The Petitioner's argument gives no effect to these considerations. In fact the construction urged by the Petitioner would in the case of combined gas and electric operation produce even less flexibility than the original Senate version.

The Petitioner relies heavily on a comment made later by Senator Wheeler, who was one of the Senate conferees and Chairman of the Senate Committee on Interstate Com-

[35] H.R. Rep. No. 1903, 74th Cong., 1st Sess. 70, 71 (1935). Parts of this language are quoted in the Petitioner's brief. Words and sentences, however, are omitted with a resulting distortion of the emphasis and meaning intended by the Managers (Br. 15-16).

merce (See Br. 16.) Senator Wheeler was by no means impartial. He had championed the Senate version of Section 11 and was dissatisfied with the compromise.[36] The statement cited by the Petitioner was made by the Senator *after* passage of the Act by both branches of Congress. It was as follows:

> "After considerable discussion the Senate conferees concluded that the furthest concession they could make would be to permit the Commission to allow a holding company to control more than one integrated system if the additional systems were in the same region as the principal system and were so small that they were incapable of independent economical operation. . . . " 79 Cong. Rec. 14479 (1935).

The Respondents submit that this statement, coming after enactment, was not part of the legislative history at all. The best reason for considering it as evidence of the legislative intent, its impact on the voting, is missing.[37] Moreover, this Court has "often cautioned against the danger, when interpreting a statute, of reliance upon the views of

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[36] See 79 Cong. Rec. 1525, 4902-04 (1935). As stated by Senator Norris before passage of the final bill but following receipt of the conference report:

> "I am firmly of the belief, however, that this is a conference report which the Senator [Wheeler] was induced to sign because he realized that he couldn't get any better. I am confident that he is not satisfied with it . . . ." 79 Cong. Rec. 14470 (1935).

Senator Wheeler spoke immediately after Senator Norris. He in no way refuted Senator Norris' judgment as to his own dissatisfaction with the conference report. He differed with Senator Norris' remarks only with respect to whether or not there could be an intermediate holding company in a holding company system. 79 Cong. Rec. 14470 (1935).

[37] See United States v. United Mine Workers, 330 U.S. 258, 279-80 (1947); Duplex Printing Press Co. v. Deering, 254 U.S. 443, 477 (1921); cf. State Wholesale Grocers v. Great Atl. & Pac. Tea Co., 154 F. Supp. 471, 485 (N.D. Ill. 1957), *rev'd on other grounds*, 258 F.2d 831 (7th Cir. 1958), *cert. denied*, 358 U.S. 947 (1959).

its legislative opponents." *NLRB* v. *Fruit & Vegetable Packers*, 377 U.S. 58, 66 (1964). Coming after the voting and from an opponent of the compromise embodied in the Act, the statement is suspect.[38] It should be considered as no more than an attempt on the Senator's part to salvage what he could from the compromise version of Section 11(b)(1).[39]

In sum, it was not a primary aim of the Act to limit each holding company system to a single integrated system. That was just what the legislative compromise rejected. The purpose was economic reform—the elimination of the evils listed in Section 1(b) and, through Section 11(b)(1), as this Court has said, to require divestment of "geographically and economically unrelated properties" in order to rejuvenate local management and restore effective state regulation:

> "Congress expressed in §1(c) its determination 'to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems,' thus eliminating the evil complained of in § 1(b)(4) and ameliorating the conditions specified in the other subsections of § 1(b). It accordingly adopted

[38] Moreover, it is inaccurate, as it states the test of Clause (A) in terms of size, and further because it indicates that the *proviso* was permissive while in fact the *proviso* requires the Commission to permit retention if the tests are met. The Petitioner also emphasizes that the statement was made "before the bill was enrolled" (Br. 16). Since enrollment is a ministerial act involving the printing of the bill and its signature by the Clerk of the House and the Secretary of the Senate (see 61 Stat. 634-35 (1947), 1 U.S.C. §106 (1964)), the significance of the Petitioner's point seems obscure. It is perhaps more relevant to note that the Congressional Record after enactment makes it clear that the debate in the Senate had in fact moved on to completely different subjects unrelated to the Act well before Senator Wheeler's statement. See 79 Cong. Rec. 14473-79 (1935).

[39] See United States v. Calamaro, 354 U.S. 351, 357-58 n. 9 (1957); Mastro Plastics Corp. v. NLRB, 350 U.S. 270, 288 (1956).

§ 11(b)(1), whereby holding companies are compelled to integrate and coordinate their systems and to divest themselves of security holdings of geographically and economically unrelated properties. In this way Congress hoped to rejuvenate local utility management and to restore effective state regulation, both of which had been seriously impaired by the existence and practices of nation-wide holding company systems." *North American Co.* v. *SEC*, 327 U.S. 686, 704 (1946). See also *Electric Bond & Share Co.* v. *SEC*, 303 U.S. 419, 436 (1938).

2. Neither the Act Itself nor its Legislative History Supports the Petitioner's Assumption of a Federal Policy against Common Control of Gas and Electric Utilities.

(a) *The Act.* Nothing in the Act states or implies that Congress considered combined gas and electric utility operation an evil to be eliminated. To the contrary, all the indications are that the policy with respect to such a combination was intended to be left to the states to determine. Federal regulation was to extend only to the point necessary to assure that the state policy was not circumvented.[40] This the Commission recognized in its Findings and Opinion below when it said,

[40] Report of National Power Policy Committee, H.R. Doc. No. 137, 74th Cong., 1st Sess. 10 (1935); S. Rep. No. 621, 74th Cong., 1st Sess. 29-30, 59 (1935); H.R. Rep. No. 1318, 74th Cong., 1st Sess. 14-15 (1935); Hearings before the House Committee on Interstate and Foreign Commerce on H.R. 5423, 74th Cong., 1st Sess. 291, 330, 344 (1935) (Analysis inserted by Chairman Rayburn); R. 1277, 1464 n. 10 and 1470-71 (the Commission's Findings and Opinion, and the opinion of the First Circuit, in this proceeding). Also see Northern States Power Co., 36 S.E.C. 1, 7, 8 (1954); Res. Ex. 57; R. 85, 1310 (listing the 25 largest combination gas and electric systems in the United States of which NEES is 15th in size). The concern of Congress basically was with "utility plants *scattered* over many States and totally unconnected in operation" (emphasis added)—not with distribution by one utility in any given community of both gas and electricity. Report of National Power Policy Committee, *supra*, 4; Hearings before Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. 460-62 (1935).

"We do not take the view that the Act expresses a federal policy against combined gas and electric operations as such." R. 1277.[41]

The Petitioner now in effect attempts to minimize this statement and approaches the subject indirectly by taking excerpts out of context and placing them in juxtaposition so as to imply competition between gas and electricity as an objective of the Act or as presumptively desirable. For example, the Petitioner says that under the Act:

"Retention was permissible if it resulted in 'the integration and coordination of related operating properties' [citing Section 1(b)(4)] under a management single-mindedly devoted to the development of those related properties in 'free and independent competition' [citing Section 1(b)(2) of the Act and parts of the Petitioner's brief]." Br. 17.[42]

The first requirement cited by the Petitioner, the "integration and coordination of related operating properties", is taken completely out of context and relevant words are omitted. Section 1(b)(4) states that the public interest and the interests of investors and consumers are or may be adversely affected —

"(4) *when the growth and extension of holding companies bears no relation to economy of management and operation or* the integration and coordination of related operating properties;" (The words omitted by the Petitioner have been italicized.)

[41] Before the First Circuit, counsel for the Petitioner sought to minimize this statement. The First Circuit noted that, "Counsel's attempt to explain this away [referring to the Commission's statement quoted above] by saying that the Commission's phrase 'as such' meant simply that the Commission was disclaiming interest when the interstate holding company form was not employed, attributes to the Commission the banality that it was not claiming jurisdiction in those cases where obviously it does not have it. We believe the Commission was saying something more than this, and that counsel, in the brief, is merely seeking some new ground to support the Commission's result." R. 1471.

[42] Similar partial quotations out of context also occur at Br. 20.

The First Circuit was disturbed by the omission of precisely the same key words in quoting from Section 1(b)(4) (R. 1461-62). The omitted words, "economy of management and operation", clearly apply to the economic test under Clause (A), and the NEES System clearly meets that requirement.

The Petitioner's second requirement, "management single-mindedly devoted to the development of those related properties in 'free and independent competition' ", can be found nowhere in the Act. The words "free and independent competition" in Section 1(b)(2) cited by the Petitioner are used in a completely different context. In that Section Congress stated that the public interest and the interests of investors and consumers are or may be adversely affected—

> "(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;"

The Act includes, in Sections 12 and 13,[43] comprehensive provisions for the regulation of those non-competitive, less than arm's-length transactions from which evils could result and which were within the concern of Congress: transactions involving such matters as sales of securities and assets in the absence of competitive conditions, service, management, construction and other similar contracts and transactions which if made within a holding company system or with its affiliates might without justification restrain competition in those areas and increase

[43] 49 Stat. 823-27 (1935), 15 U.S.C. §§ 791, 79m (1964).

charges to operating companies, in turn increasing the basis for their rates to consumers and reducing the return to investors. It is with such matters that Section 1(b)(2) is concerned.[44]

The Report filed by Senator Wheeler which accompanied S. 2796 stated detailed findings of which the following relate to non-competitive conditions and so provide the basis for that section of the bill which is now Section 1(b)(2) of the Act:

> "(7) subsidiary public-utility companies are often subjected to excessive charges for services, construction work, equipment, and materials to the detriment of investors and consumers; (8) subsidiary public-utility companies often enter into transactions with affiliates in which the absence of arm's-length bargaining operates to the detriment of investors and consumers; (9) control of subsidiary public-utility companies throughout the United States has often been used to secure to holding companies, their affiliates, and subsidiary construction companies construction work for public-utility companies in restraint of free and independent competition in that field; (10) service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States and present problems of regulation which cannot be dealt with effectively by the States without the assistance of the Federal Government; (11) control of subsidiary public-utility companies materially affects the accounting practices and rate, dividend, and other policies of such companies,

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[44] The rules of the Commission adopted under the Act to implement the regulation of transactions of this kind include Rule 50 (requiring competitive bidding in securities underwritings), Rule 70 (b)(2) (forbidding issue of securities to certain financial institutions with which the issuer has an interlocking officer or director), Rules 43, 44 and 45 (implementing Sections 12(d), (f) and (g) of the Act calling for maintenance of competitive conditions with respect to sales of securities and utility assets and intrasystem transactions) and Rules 80-95 (regulating service, sales and construction contracts). 17 C.F.R. §§ 250.50, 250.70(b)(2), 250.43-45, 250.80-95 (1964).

thereby in many instances complicating and obstructing State regulation of such subsidiary companies; . . . .'"[45]

(b) *Legislative History of Section 8.* Section 8 of the Act, dealing with acquisitions, is highly relevant on the question of federal and state policy concerning common control of gas and electric utility services. In Section 8, Congress provided that where state law prohibits or requires approval of combined gas and electric operation, a holding company may not acquire gas and electric companies serving the same territory without express approval of the state commission. Sections 9 and 10 impose additional conditions on acquisitions, but Section 9(b)(1) specifically exempts an acquisition of utility assets by a public-utility company if approved by state authority. The Act thus indicates a broad federal deference to state policy with respect to combination of gas and electric operations and an intent to assure the effectiveness of that policy and not, as happened here, to override and disregard the expressed position of the state regulatory body based on state public policy and the particular local conditions.[46] Indeed,

[45] S. Rep. No. 621, 74th Cong., 1st Sess. 21-22 (1935). The Petitioner cites to the contrary a statement by Senator Couzens indicating his concern with competition between electric lighting and gas (Br. 35 n. 25). It seems significant (i) that this is the only such reference in the entire Senate hearing, (ii) that the Mr. Benton with whom Senator Couzens was arguing was the General Solicitor of the Natonal Association of Railroad and Utilities Commissioners and (iii) that Mr. Benton promptly proceeded to refute Senator Couzens' approach to this issue. Hearings Before the Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess. 746, 783 (1935).

[46] Notwithstanding the DPU's unequivocal position in favor of NEES' retention of its gas companies, the Petitioner seems to suggest that Massachusetts policy is not as stated by the DPU and for this purpose cites excerpts from the DPU decisions in *Cambridge Gas* and *Lynn Gas & Electric* (Br. 36 n. 25). The quotation from *Cambridge Gas* dates from 1930, and omits significant language which shows that the principal reason for refusing approval of the merger of the Cambridge Gas and the Cambridge Electric companies was to preserve for the City of Cam-

the Report of the House Committee on Interstate and Foreign Commerce which accompanied the House version of S. 2796 stated with respect to Section 8(b), which constitutes the entire Section 8 in the Act as passed:

> "Subsection (b) prevents any company in a system from taking any step which would result in the [sic] bringing into the same holding company system a gas-utility company or an electric-utility company serving substantially the same territory as that served by any utility company in the system, where State law prevents the combination of the gas utility and electric utility in the same company. This subsection is concerned with competition in the field of distribution of gas and electric energy—a field which is essentially a question of State policy, but becomes the proper subject of Federal action where the extra-State device of a holding company is used to circumvent State policy."[47]

In the early versions of the Act, Section 8 made it unlawful after January 1, 1937 for a registered holding company, without state approval, to have an interest in an electric company and a gas company serving substantially the same territory, if the applicable state law prevented or required authorization of the ownership or operation of the gas and electric properties by a single company.[48]

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bridge the right to take over either the gas or electric business without the other. Cambridge Gas Light Co., P.U.R. 1930D 263, 265 (Mass. DPU 1930). Presumably, merger of the two Cambridge companies has not been sought again since they enjoy the economies of joint operation under the common control of New England Gas & Electric Association which is now exempt from the Act because its operation has been brought entirely within Massachusetts. The quotation from *Lynn Gas & Electric* does not reflect the result in that case and the evidence in this case (R. 71-73, 110, 144); namely that the transaction there approved by the DPU was a rearrangement continuing the two businesses *under the same NEES ownership*—the very arrangement which the Petitioner in this case has attempted to break up. Lynn Gas & Elec. Co., 31 P.U.R. 3d 209 (Mass. DPU 1959).

[47] H.R. Rep. No. 1318, 74th Cong., 1st Sess. 14 (1935).

[48] S. 1725 § 8(d) (1935) and H.R. 5423 § 7(d) (1935).

This provision was removed from Section 8 by the Senate Committee on Interstate Commerce with the idea that a forced break-up of such combinations should be effected under the orderly procedures of Section 11 rather than by an inflexible, flat prohibition within a fixed time under Section 8.[49] In considering the implications of Section 8 and its history generally, and this change in particular, it is vitally important to keep in mind that Section 8 in all stages of its development related solely to prevention of the use of interstate holding company systems to circumvent state policy, that is, to accomplish indirectly what state law prevents being done directly. The Petitioner's discussion of the topic and use of quotations relating to it (Br. 35-36) seem to overlook this important fact completely.

The Senate Report, which was filed with S. 2796 by Senator Wheeler and which had his entire support, included the same comment as the House report:

> "This subsection [in substance the present Section 8] is concerned with competition in the field of distribution of gas and electric energy — a field which is essentially a question of State policy, but becomes the proper subject of Federal action where the extra-State device of a holding company is used to circumvent State policy." S. Rep. No. 621, 74th Cong., 1st Sess. 29-30 (1935).

3. Permitting "Meaningful Consideration of the Competitive Advantages" of Separate Operation of the Gas Companies is not a Reason for Favoring the Petitioner's Test.

(a) *The Competition Factor.* The Petitioner explains that its test under Clause (A) really turns "on something more than mere size [of the economies to be lost] measured in dollars *or percentages*" (Br. 34, emphasis added), and

[49] S. 2796, introduced May 9, 1935 by Chairman Wheeler of the Senate Committee on Interstate Commerce, § 8(d). See S. Rep. No. 621, 74th Cong., 1st Sess. 4, 7-8 (1935).

that the requirement of "something more" enables the Commission, where a combination of gas and electric utilities is being examined, to take into account the competitive advantages of eliminating common control, without being required to state even approximately what weight it attributes to them or by what standard it measures them. The argument proceeds on the basis of their being "very real, although immeasurable, substantial competitive advantages" (Br. 38). It is another expression of the Petitioner's false assumption that the Act embodies a federal policy against combined gas and electric operations, discussed at pp. 33-39 above.

Respondents and the court below do not quarrel with the Petitioner's point that the competitive factor is relevant and should be considered in testing the substantiality of the economies to be lost upon severance. This obviously is a part of the business judgment which the court below called for (R. 1464, 1469-70), but the total competitive situation, not merely the competition between gas and electricity, must be examined. It was for this reason that the Respondents introduced extensive evidence concerning the total competitive situation of the NEES gas companies, with respect to both the competition between gas and electricity and, in Massachusetts, the far more significant competition between gas and fuel oil.

As to the competition between gas and electricity, the evidence, which was uncontroverted, showed that the operation of the gas companies as a part of the NEES System under the supervision of the separate Gas Division provides aggressive promotion and high standards of service under competent management devoted exclusively to the gas business, in no way suppressing or hampering competition between gas and electricity or favoring either to the detriment of the other.[50] The chairman of the DPU testi-

[50] R. 66-67, 71-74, 138-39, 170-82, 191-98, 206-09, 220-30, 307-15, 393-401, 501-02, 506-07, 511-12, 517-18.

fied to the same effect (R. 589, 594). As to the competition between gas and fuel oil, the evidence showed severe competition for the space heating market, which is the principal market for gas (R. 232, 715), and in view of that competition, the particularly adverse impact that rate increases resulting from the loss of economies would have upon the overall competitive position of the gas companies (R. 221-22, 227-28, 232-39, 721-23). The Chairman of the Massachusetts DPU was quite explicit on these points. He testified to the serious concern of his Department over the loss of what he considered very substantial economies and resulting increases in rates to consumers which, in his judgment, would have an adverse impact upon the gas companies' ability to compete with oil (R. 589, 590-92).

The Petitioner nonetheless discusses in broad and generalized terms the problems that have arisen in prior divestment cases involving gas and electric companies, and notes that various potential abuses can result from combined operation (Br. 34-38). However, in this case, the evidence showed that no such abuses have resulted, and that for years NEES has taken effective measures through separate management to prevent their occurring[51]; and thus the Petitioner can do no more than note that the "Commission recognized that joint control by NEES . . . *could well* lead to the favoring of one kind of service to the disadvantage of users of the other." (Br. 37. Emphasis added.)

The Petitioner's position seems to be that if independent operation is possible, the Commission should be free to conclude that the gas companies and their customers should bear the burden of the loss of proven significant economies, in order to protect them against what are no more than potential future abuses, and that the test under Clause (A) should be such as to permit that result. Divestiture would be ordered now on no firmer ground than the hope that

[51] See n. 50 above.

competitive advantages, which are necessarily purely speculative, will be sufficient to overcome not only the loss of proven economies, but also, in this case, significant disadvantages in the primary competition of gas with oil. There is no need for such a decision now as the Commission will have continuing jurisdiction to correct abuses should they arise in the future.

If the Petitioner's rationale is accepted, the Commission will have a "carte blanche." The burden of proof can never be met. Even if, as was the case here, the only evidence in the record shows that there will be a significant loss of economies, and, in addition, shows not only that no benefits will result from separation but further that significant competitive disadvantages will result, the Commission nonetheless will be free to assume the contrary and give unlimited weight to this factor without any standard of measurement. The First Circuit did not question the Commission's right to consider competitive advantages, but it did indicate that at least a finding of approximate financial benefit should be made, particularly "where the evidence shows that NEES has made a special effort to obtain for its gas system many of the benefits of independence." R. 1470. This certainly is the minimum that a reviewing court can require in order to assure that the administrative action is not arbitrary. If Petitioner is right, judicial review as a practical matter will be meaningless, and the Commission will have at least as much latitude as it would have had under the House version of S. 2796, which the then Chairman of the Commission described as too broad a delegation of power.[52]

(b) *Choice of tests.* The justification for the test urged by the Petitioner would be relevant only in cases involving combinations of gas and electric systems. It is meaningless when an additional gas system is sought to be retained with a principal gas system, or an additional elec-

[52] Letter of Joseph P. Kennedy, 79 Cong. Rec. 10838 (1935).

tric system is sought to be retained with a principal electric system. It is false reasoning to justify a test based on administrative convenience when that justification is relevant in only some cases, but not in all. The ABC tests do not make the distinction between different kinds of utility operation which the Petitioner's argument would require.

It is also false reasoning to favor a test because it fits particular factors to which the Commission wishes to give effect instead of determining the test intended by Congress and then giving effect to such factors as are relevant to that test.

Finally, the Petitioner's brief leaves unanswered the obvious question of how competitive advantages or disadvantages of independence can be more easily or effectively given "meaningful consideration" under the Commission's test than under the court's test. Just the reverse would appear to be true. It would seem easier to give consideration to this somewhat speculative factor, which the Petitioner says is "immeasurable", as one of the general circumstances in determining the substantiality of economies (a relative matter in any case) than in making an absolute yes-or-no determination of the ability of the system to continue economic operation.

III. The Record of Administrative Interpretation of Clause (A) by the Commission is not such as to Warrant "Great Deference" from the Court.

The Petitioner asserts that the standard which it now urges for Clause (A) is a long standing judicially approved administrative test which has been consistently applied by the Commission and which is entitled to great deference from this Court (Br. 10, 26-27).[53]

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[53] Notwithstanding the Petitioner's suggestion that the Court should defer to the Commission's interpretation of Clause (A), the question whether an administrative agency's interpretation of a statute is correct is ultimately for the Court to determine. NLRB

In its Petition for a Writ of Certiorari the Petitioner told the Court that in this case it had applied under Clause (A) the same test as "it had applied in every other divestiture case under Section 11(b)(1)" (Pet. 5), and that under that test "more than $2,000,000,000 in utility assets have heretofore been divested on orders of the Commission" (Pet. 12).

The contention is now somewhat equivocated. In its brief the Petitioner suggests that in the earlier cases the test applied by the Commission really was "essentially the same" (Br. 27), that the Commission has "reemphasized the same themes" as were reflected in an earlier decision (Br. 28-29), and that the seemingly different tests stated by the Commission are nothing more than a "variation in choice of words, due for the most part to the varying contentions with which the Commission was dealing" (Br. 30).

Even in the course of this case, the Petitioner has stated a bewildering variety of different versions of its test with the result that it is very difficult to know just what that test is and, as the court below noted, to determine whether there is a difference between the Commission's test and a test of ultimate bankruptcy, and if there is a difference, the standard by which unsound and uneconomical operation is to be determined. (See R. 1458 n. 5). The tests stated by the Commission in its Findings and Opinion range from the test based "solely upon whether the increased operating costs occasioned by severance are 'substantial'" (R. 1273), apparently looking solely to the change in operating costs, to the other extreme that additional systems could be retained only if they were " 'so small that they were incapable of independent economic operation.' " (R. 1261).

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v. Hearst Publications, Inc., 322 U.S. 111, 130-31 (1944). In the final analysis the phrase "substantial economies" sets forth a legal standard and it must get its final meaning from judicial construction. *Cf.* FTC v. Colgate Palmolive Co., 380 U.S. 374, 385 (1965).

Other tests stated in the instant case include:

(i) There must be " 'real economic need' for management together. . . ." R. 1261;

(ii) The economies must have been "substantial in the sense that they were important to the ability of the additional system to operate soundly." R. 1261-62;

(iii) The loss of economies must be "so important as to cause a serious impairment" of the additional system. R. 1263;

(iv) " 'The loss of substantial economies' must be such as to render the additional system incapable of sound and economical operation independent of the principal system." Pet. 2;

(v) " 'such additional system cannot be operated under separate ownership without the loss of economies so important as to cause a serious impairment.' " Pet. 5;

(vi) "a holding company may not retain an additional . . . system unless it can show that such system is incapable of independent economical operation." Pet. 12; and

(vii) "a loss is not 'substantial' unless it would render impossible 'economical or efficient operation' " R.1458.[54]

1. The Prior Administrative Decisions under Clause (A) are Seriously Inconsistent and Confusing.

The earlier decisions of the Commission tend to show a "variation in choice of words", as the Petitioner now puts it (Br. 30), similar to that in the instant case. Analysis

[54] The court below criticised the Commission for its use of the word "efficient" which is taken from Section 1(b)(5) where it is used in connection with service and does not relate to the test of economy (R. 1463). The Petitioner in no way refutes or questions this analysis but instead now presents a different test which is not concerned with efficiency of service but is based on the concept of "soundness", presumably meaning financial soundness. In its 31st Annual Report, for the year 1965, the Commission reported to Con-

of these prior decisions leads to the conclusion that the test urged by the Petitioner in its brief is not of long standing and has not been consistently applied.

Of the more than $2,000,000,000 of assets which the Petitioner claims have been divested under the test which it now urges, approximately $1,062,800,000 of assets, or more than half, directly contradict the Petitioner's argument.[55] The interpretation applied in the divestiture of these assets was the one set forth by the Commission in *North American*, and followed by the Commission in several later cases: that the words should be given their normal and usual meaning connoting economies which would be important or significant in light of the circumstances:

> "The normal and usual meaning of the word 'substantial' is a meaning connoting 'important'. And we think that this normal and usual meaning is compelled here. The degree of importance must be measured against the vital policy to which Clause (A) is an exception, *i.e.*, the policy of limiting holding companies to the operation of a single integrated public utility system."[56]

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gress that the test it had applied in this case was whether the additional system would be "incapable of independent economic operation". Securities and Exchange Commission, *31st Annual Report* 86 (1965).

[55] See Item 1 in Appendix B to this brief.

[56] North American Co., 11 S.E.C. 194, 209 (1942). On review, the Second Circuit approved the interpretation of "substantial" economies as meaning "important" economies, not merely something more than nominal, but said nothing as to the Commission's further reference to a policy of limiting holding companies to one system. North American Co. v. SEC, 133 F.2d 148, 152 (2d Cir. 1943), *aff'd on constitutional issues*, 327 U.S. 686 (1946). In its Brief the Petitioner omits entirely the test of substantiality formulated by the Commission in *North American*, and instead says that in the case (i) the Commission quoted "with approval" the remarks made by Senator Wheeler after passage of the Act (it did not); and (ii) the Commission "significantly stressed the importance of independent management, single-mindedly devoted to the operation of integrated properties and to the interests of the stockholders therein" (again, it did not). See Br. 28; 11 S.E.C. at 209, 211.

In *Engineers*,[57] involving another divestiture of approximately $23,600,000 of assets, the Commission stated an intermediate test—loss which "would seriously impair the effective operations of the systems involved"—something more serious apparently than merely important, but not necessarily serious enough to destroy, only seriously impair, the capacity for effective operations. However, the actual decision rested on inadequacy of proof.

Additional divestitures of approximately $750,100,000 of assets are irrelevant for the reason that the evidence in the cases was insufficient under any standard and the Commission disposed of all of them without stating any interpretation of Clause (A).[58]

There remain three cases[59] involving divestiture of approximately $146,400,000 of assets, or less than 7½% of the $2,000,000,000 claimed by the Petitioner. In these three cases only has the Commission stated as its test under Clause (A) a standard similar to, not always identical with, its present test but in none of them does it appear that the test was the determining factor which led to the divestiture order. In *Philadelphia*, the Commission's opinion on the Section 11(b)(1) question was devoted principally to a criticism of the evidence and of the qualifications of the expert witness who testified on behalf of the respondent. The Commission rejected the evidence of the economies to be lost in its entirety. In the second case,

[57] Engineers Pub. Serv. Co., 12 S.E.C. 41, 57-65, 79-81, 86-88 (1942). In its description of this case in its brief (Br. 29-30) the Petitioner again fails to report the test of substantiality formulated by the Commission in *Engineers*. Instead Petitioner furnishes extensive quotations on the evidentiary issues which, although the principal issues in *Engineers*, are not in issue here: namely, whether evidence of "increased *expenses*" without more could show "loss of *economies*", and the conclusion that "clear and convincing evidence" should be required. Br. 29-30; 12 S.E.C. at 57-58, 60-61. See Item 2 in Appendix B to this brief.

[58] See Item 3 in Appendix B to this brief.

[59] See Item 4 in Appendix B to this brief.

General Public Utilities, the Respondent did not contest divestiture, and in the third case, *Middle South Utilities*, the Respondent had submitted no study of any kind to show the economies to be lost by the additional system upon severance.

The Petitioner states in its brief that the Respondents "concede" that in the period since *Philadelphia* "the Commission has articulated no different test from the one it applied here" (Br. 27). That is somewhat misleading. More accurately stated, the Respondents' position is that only in *Philadelphia* and two cases since *Philadelphia*, being three out of the total of thirteen cases cited by the Petitioner, has a test like the present test even been "articulated" by the Commission (in the two other cases since *Philadelphia* no test was stated[60]); that these three cases involved less than 7½% of the assets claimed by the Petitioner to have been divested under the test which it now advocates; and that even in these three cases the test was not determinative.

In brief, the Respondents say that the test is not long standing and that by no means has it been consistently applied.

2. The Weight of Judicial Decisions is Against the Petitioner's Position.

The test now urged by the Petitioner has been placed squarely in issue in two Courts of Appeals — in the First Circuit in this case and in the Fifth Circuit in the *Louisiana* case.[61] Both times the test has been rejected by a unanimous court.

[60] See Item 3 in Appendix B to this brief.

[61] Louisiana Pub. Serv. Comm'n v. SEC, 235 F.2d 167, 173 (5th Cir. 1956), *rev'd on jurisdictional grounds*, 353 U.S. 368 (1957). The Petitioner suggests that *Louisiana* has "no legal consequence" (Br. 33-34 n. 23) because this Court later reversed on jurisdictional grounds. So far as the parties to the case itself were concerned, that contention may have some meaning. However, the importance of the case as a definite and unanimous statement of the view of the Fifth Circuit is unimpaired, as clearly the Fifth Circuit thought that it did have jurisdiction and was in fact deciding the issue.

Three earlier Circuit Court cases also involved Clause (A) but they give the Petitioner's present position little, if any, support.

In *North American*[62], the first case, the Second Circuit approved the Commission's interpretation in *North American* noted above: that "substantial" economies means "important" economies and not merely something more than nominal. The court naturally made no reference to the Commission's present interpretation, as it had not then been formulated.

In the second case, *Engineers*,[63] the District of Columbia Court of Appeals adopted the Second Circuit's interpretation in *North American*, but enunciated it at greater length. The majority of the court concluded there were three factors to be considered in determining "substantial economies", namely, that there be "a continuing substantial strength, enjoyed by the controlled company which it would not have under its own control", that there was "no reasonable expectation that a compensating strength would not be enjoyed by reason of its own control", and that the continuing strength of the controlled company "would not entail a sacrifice on the part of the controlling utility."[64] However, the decisive issue in *Engineers* was not the meaning of "substantial" but

[62] North American Co. v. SEC, 133 F.2d 148, 152 (2d Cir. 1943), *aff'd on constitutional issues*, 327 U.S. 686 (1946). The Petitioner has failed to cite or discuss the Second Circuit's decision in its brief.

[63] Engineers Pub. Serv. Co. v. SEC, 138 F.2d 936, 944 (D.C. Cir. 1943), *cert. granted*, 322 U.S. 723 (1944), *dismissed as moot*, 332 U.S. 788 (1947).

[64] These three factors comprise a test of Clause (A) far less harsh than that advocated by the Petitioner in this case. The loss of a "continuing substantial strength" would be less than the loss of the capability of sound and economical operation (see above at pp. 44-45); "no reasonable expectation" is far different from an unsubstantiated presumption of offsetting benefits (R. 1470); and "sacrifice on the part of the controlling company" is recognition of an adverse effect on the principal system, which the Commission in the instant case considers irrelevant (R. 1264 n. 14).

whether the net effect of divestment could be established by evidence of operational savings through combined operations, without more. On this question the court divided, with the majority approving the Commission's requirement of "a clear and convincing showing that the operational savings through combination would be sufficient to support a finding that such single item of saving would constitute an overall substantial economy." Deciding the case on the inadequacy of the evidence, the majority did not reach the Commission's interpretation of "substantial" as used in Clause (A).[65]

In the third case, *Philadelphia*[66], the District of Columbia Court of Appeals held that the Commission had not acted unreasonably in rejecting the utility's estimate of increased operating expenses as insufficiently established. The court added, moreover, that as was stated in *Engineers*, the mere showing of a material saving in operational expenses does not necessarily show the overall situation. The court agreed that the Commission could find support for its interpretation of "substantial economies" in parts of the legislative history. However, the court did not hold that the Commission's interpretation of "substantial" was correct; for the purposes of the decision that was not necessary. The court concluded:

> "'Substantial' is a relative and elastic term. Petitioners concede that economies, to be substantial, must be 'important.' We cannot say the Commission's under-

[65] The dissent by Judge Soper suggested that substantial savings in operational expenses can be substantial economies, and so in his dissent (unlike the majority opinion) the standard applied by the Commission had to be considered. Judge Soper's view was that the Commission was "putting it too strongly" to say "that there must be clear and convincing evidence of loss of economies which would seriously impair the efficiency of the systems." 138 F.2d at 945.

This Court granted a writ of certiorari in *Engineers*, and argument was heard, but the case was subsequently ordered vacated as moot. See n. 63 above.

[66] Philadelphia Co. v. SEC, 177 F.2d 720, 724 (D.C. Cir. 1949).

standing of the term 'substantial economies' is wrong. We construed it similarly in the Engineers case." 177 F.2d at 725.

In sum, the Commission's present test has been placed squarely in issue twice, before the court below and in *Louisiana*. Both times it has been rejected. The earlier cases, *North American* and *Engineers*, involved a far less severe test, and in *Engineers* the actual decision pertained only to the evidentiary issue. *Philadelphia's* support for the Petitioner's test is weak: it is *dictum*, and the court itself thought it was going no further than it had in *Engineers*.[67]

CONCLUSION

For the reasons stated, the decision of the court below should be affirmed.

Respectfully submitted,

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March 9, 1966

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[67] The Respondents' reading of the *Engineers* and *Philadelphia* decisions is essentially the same as the Fifth Circuit's in *Louisiana*. See 235 F. 2d at 173.

APPENDIX A

Statute Involved

Sections 1(b) and (c), 2(a)(29), 8 and 11(b)(1) (A)-(C) of the Public Utility Holding Company Act of 1935*

Section 1....

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

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*49 Stat. 803-04, 810, 817, 820 (1935), 15 U.S.C. §§ 79a(b) and (c), 79b(a)(29), 79h, 79k(b)(1) (1964).

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated become persistent and widespread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of

properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

SECTION 2. (a) When used in this title, unless the context otherwise requires—

. . .

(29) "Integrated public-utility system" means—

(A) As applied to electric utility companies, a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation; and

(B) As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operation to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: *Provided,* That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

SECTION 8. Whenever a State law prohibits, or requires approval or authorization of, the ownership or operation by a single company of the utility assets of an electric utility company and a gas utility company serving substantially the same territory, it shall be unlawful for a registered holding company, or any subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, —

(1) to take any step, without the express approval of the State commission of such State, which results in its having a direct or indirect interest in an electric utility company and a gas utility company serving substantially the same territory; or

(2) if it already has any such interest, to acquire, without the express approval of the State commission, any direct or indirect interest in an electric utility company or gas utility company serving substantially the same territory as that served by such companies in which it already has an interest.

SECTION 11. . . .

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of sub-

stantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

. . . .

APPENDIX B

Classification of Administrative Cases Listed In Appendix B To The Petition for a Writ of Certiorari[1]

	Assets Divested
1. Cases stating or following test set forth by the Commission in *North America* (11 S.E.C. 194 (1942)):	
North American Co., 11 S.E.C. 194, 209 (1942)	$ 659,158,089
Cities Serv. Power & Light Co., 14 S.E.C. 28, 37, 47-48 (1943)[2]	59,995,535
Middle West Corp., 15 S.E.C. 309, 319 (1944)	97,751,921
Cities Serv. Co., 15 S.E.C. 962, 984 (1944)	148,258,253
American Gas & Elec. Co., 21 S.E.C. 575, 596-97 (1945)	97,684,103
Sub total	$1,062,847,901
2. Proof inadequate but an intermediate test stated, namely, the loss "would seriously impair the effective operations of the systems involved" (12 S.E.C. at 61):	
Engineers Pub. Serv. Co., 12 S.E.C. 41, 57-65, 79-81, 86-88 (1942)	$ 23,571,236
3. Evidence insufficient under any standard and no interpretation of Clause (A) stated by Commission:	
North American Co. (St. Louis Properties), 18 S.E.C. 611, 613-15, 621 (1945)	$ 13,129,400
Peoples Light & Power Co., 20 S.E.C. 357, 380-81 (1945)	182,000
Commonwealth & Southern Corp., 26 S.E.C. 464, 487-90 (1947)[3]	722,259,916

	Assets Divested
Penn. Gas & Elec. Corp., 28 S.E.C. 553, 558 (1948)	$ 2,349,409
Eastern Util. Ass'tes, 31 S.E.C. 329, 348-52 (1950)	12,234,309
Sub total	$ 750,155,034
4. Test similar to Commission's present interpretation stated, but not determinative:	
Philadelphia Co., 28 S.E.C. 35, 46-47, 53-74 (1948)	$ 113,605,913
General Pub. Util. Corp., 32 S.E.C. 807, 814-15, 826-27, 831 (1951)	13,757,386
Middle South Util., Inc., 35 S.E.C. 1, 11-13 (1953)	19,061,622
Sub total	$ 146,424,921
Grand Total	$1,982,999,092

[1] Figures are taken from that Appendix as they cannot in most instances be verified from the cited cases.

[2] Includes one subsidiary (net assets of approximately $422,000 or only approximately 1% of the assets ordered divested in the case) as to which the Commission said that, although it was small, the record did not show the company was "incapable of economic, independent operation". This was viewed as "*one* of the guides which (*among others*) Congress intended to be used. . . ." 14 S.E.C. at 62. (Emphasis added.) Significantly, this language was not cited in support of the interpretation stated in *Philadelphia*. (See Item 4 above.)

[3] Includes one subsidiary (net assets of approximately $28,000,000 or only approximately 4% of the assets ordered divested in the case) which the utility had agreed to divest and which the Commission held not retainable under Clause (C) but as to which the Commission also quoted the language stated in note 2 above. 26 S.E.C. at 487, 489.